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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

May 8, 2000

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
The Portals
445 Twelfth Street, NW
Washington, DC 20054

Re: **In the Matter of Coalition for Affordable Local and Long Distance Service (CALLS); CC Docket Nos. 94-1, 96-45, 99-249, and 96-262**

Dear Ms. Salas:

This ex parte filing addresses the core legal defect in the proposed CALLS plan: its proposed "targeting" of productivity reductions to certain baskets where the incumbent telephone companies face competition, rather than allocating reductions among all baskets as required by the Commission's rules. I discussed this issue with Chris Wright, General Counsel of the Commission, and John Neuchterlein and Debra Weiner of the OGC, on Friday, May 5, 2000, accompanied by Jonathan Askin of ALTS, and Pat Donovan, counsel for Focal Communications, to insure this issue was raised "with sufficient force to require an agency to formally respond".[1] While other defects of the CALLS proposal were also addressed in the comments of Focal, ALTS, and other parties to this proceeding, the "targeting" aspect of the CALLS proposal is a blatant and unequivocal violation of the Commission's rules.

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[1] MCI WorldCom, Inc. v. FCC, slip opinion at 9 (D.C. Cir. No. 96-1459, April 28, 2000).

The current version of the CALLS proposal "targets" productivity revenue reductions to local switching and transport rates until the ILECs' rates hit certain pre-determined levels.[2] However, the Commission's rules clearly require that such revenue reductions be applied to all baskets (47 C.F.R.§ 61.3):

> "(w) Price Cap Index (PCI). An index of prices applying to <u>each basket of services of each carrier</u> subject to price cap regulation, and calculated pursuant to § 61.45." (Emphasis supplied.)
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> * * *
>
> "(z) Productivity factor. An adjustment factor used to make annual adjustments to the Price Cap Index to reflect the margin by which a carrier subject to price cap regulation is expected to improve its productivity relative to the economy as a whole."

Nowhere in its filing does CALLS seek a waiver of the Commission's rules, or nor does it attempt to meet the standards that apply to such waiver requests.[3] The only arguments raised by CALLS are that: (1) Focal and other parties do not claim the rates resulting from this "targeting" are predatory;[4] and (2) including the common line basket in productivity reductions would "reduc[e] incentives to invest in distribution alternatives to the incumbent LEC loops."[5]

Neither of these arguments justifies CALLS' efforts to escape the price cap rules. The Commission's price cap rules were intended to protect competition even though competitors also had the right to file complaints against ILEC rates they deemed predatory.[6] Among the rules which protect competition are the API and the upper pricing band mechanisms. Indeed, the Commission remarked in the NPRM creating this proceeding that it had removed certain price cap rules because the continued applicability of "the PCI and upper pricing bands adequately control predatory pricing ...."[7] By

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2 CALLS Reply Comments filed April 27, 2000, in CC Docket No. 94-1 <u>et al</u>., at 36-37

3 <u>Northeast Cellular Telephone Co., L.P</u>. v. <u>FCC</u>, 897 F.2d 1164, 1167 (FCC's issuance of waiver must be reversed where it was not based on any rational waiver policy).

4 CALLS Reply Comments at 10.

5 <u>Id</u>. at 2. Because the ILECs' productivity reduction filing is obligatory (<u>see</u> Rule 61.43), CALLS cannot argue that its proposal is not subject to the price caps rules.

6 <u>See</u>, <u>e.g.</u>, <u>Price Cap Performance Review for Local Exchange Carriers</u>, First Report and Order at para. 26 (release April 7, 1995).

7 NPRM at para. 15.

circumventing these anti-predation mechanisms, the CALLS proposal would permit exactly the kind of predation they were created to prevent.

CALLS' second position is that exclusion of productivity reductions from the common line basket stimulates competition for these ILEC services. But this argument proves too much, since it would justify the basic predatory behavior that the structural aspects of price cap regulation are intended to deter. All earnings-constrained multi-service providers with market power will attempt to increase prices on less competitive services (such as the ILECs' common line services) while lowering prices on their more competitive services (such as switching and trunking) absent any pricing constraints.

GTE tries to defend "targeting" by pointing to the Commission's targeting of the residual TIC upon remand from the D.C. Circuit's finding that this rate element had not been properly cost-justified.[8] The Commission declined to formulate such a justification, and ordered instead that this element be eliminated,[9] also adopting specific rules to govern this elimination.[10] Because the residual TIC was not cost-based, the targeting of productivity changes at the residual TIC was mathematically equivalent to allocating this amount pro rata over all baskets, and then applying the reduction to each. More fundamentally, however, the Commission adopted specific rules authorizing such an approach. CALLS seeks no new rules here, and cannot demonstrate any basis for waiving the existing rules.

Finally, the fact that other revenue reductions in the CALLS proposal might comply with the Commission's rules simply underscores the irrationality of the targeting. Price cap rules must be applied to all aspects of a productivity adjustment, particularly one that involves substantial universal service support.

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[8] GTE Reply Comments filed April 19, 2000, at 32-33.
[9] Price Cap Reform Order at para. 232 (released May 16, 1997).
[10] Rule 69.155

Pursuant to Section 1.1206(b)(1) of the Commission's rules, two copies of this letter are included for filing.

Yours truly,

Richard J. Metzger/ctmr

Richard J. Metzger

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